II. Accounting and Auditing in Uzbekistan

This chapter presents an overview of accounting and auditing arrangements in Uzbekistan. It provides context for the following chapters on professional infrastructure, accounting and auditing standards, accounting and auditing training, and government budgeting and accounting arrangements. The chapter comprises 12 sections, in two parts, as follows:

Part One. Accounting

1 – Introduction

2 – Issues and Responses since 1991 – describes the issues that faced Uzbekistan in 1991 when the transition process to a market economy began. It also summarizes the actions that were taken in response to these issues.

3 – The 'Uzbekistan Accounting System' – describes accounting arrangements including: governing laws and regulations, accounting bases, asset management and internal control systems, and accounting information systems.

4 – Financial Reporting Requirements – describes financial reporting requirements and efforts to convert enterprises to international accounting standards.

5 – Bookkeepers and Accountants – describes the estimates of bookkeepers and accountants in Uzbekistan and why these estimates appear so high.

Part Two. Auditing

6 – Introduction

7 – Governing Laws and Regulations – describes the laws that govern Uzbekistan auditing practices and audit requirements.

8 – Audit Requirements – describes the requirements for organizations to be audited.

9 – Auditor Licencing – describes the process and requirements for auditor licensing.

10 – Bank Auditing – describes arrangements for auditing banks.

11 – Public Sector Auditing – identifies issues that complicate the public sector auditing process.

12 – Accounting and Auditing Firms – describes the presence of domestic and international accounting firms in Uzbekistan.

Part One. Accounting

1. Introduction

Accounting in the Soviet Union, which included Uzbekistan, catered to the needs of statistical and tax authorities. It did not provide the information required by securities markets or company managers in a market economy. Nor did it support an economically rational system of enterprise taxation, since many production costs were not deductible for tax purposes (e.g., certain payroll and interest expenses).

In common with other former Soviet Union (FSU) countries, Uzbekistan has little history or tradition of using market-based accounting concepts such as going concern, accrual basis, consistency and substance over form. In particular, the Soviet accounting system strictly applied the historical cost convention to record assets – assets that were never revalued. Moreover, provisions for doubtful debts or obsolete inventories were not estimated – doubtful accounts were written off only when they were clearly not collectable. In essence, a risk-free environment was assumed where no thought need be given to valuation of assets or determination of profit. Goods were not bought and sold in a free market and there was no risk of a decline in value. Enterprises did not answer to investors, bankers, or regulators for their performance.

Accounting consisted of adhering to a prescribed chart of accounts that was designed to meet the requirements of the central planning system. The primary function of accounting was to record the factual data necessary to assess plan accomplishments, rather than to assess an enterprise's financial situation. The focus of Soviet accounting was more on bookkeeping than on the process of accounting. In fact, they were considered the same thing. Accounting, however, involves much more than bookkeeping. Bookkeeping only entails the recording of economic events while the accounting process includes application of generally accepted accounting standards to identify, measure, record, and report those events and their effect on an enterprise. Consequently, public accounting firms and an accountancy profession were never necessary. In fact, accountancy had a very poor reputation in the FSU. One study ranked accountancy at 91st place in terms of prestige on a list of 92 professional occupations.[18]

[18] Smirnova, Irina, Jaroslav Sokolov and Clive Emmanuel. 1995. Accounting Education in Russia Today, *The European Accounting Review.* 4(4), 833-46.

On independence from the Soviet Union in 1991, Uzbekistan took a gradual approach to market reforms. These reforms included making accounting and financial reporting practices and arrangements consistent with the needs of a market economy. However, the Soviet accounting system created a sound basis on which to build. First, the system used many concepts of modern accounting including accrual measurement and double entry bookkeeping. Second, large numbers of bookkeepers were trained in these concepts and were proficient in their application.

2. Issues and Responses since 1991

In the decade since the beginning of the transition, Uzbekistan has made gradual progress in terms of developing an accounting infrastructure suitable to the needs of a market economy. The magnitude of these accomplishments is best viewed by examining the 1991 situation. First, bookkeepers numbered in their hundreds of thousands but there were no qualified Certified Public Accountants (CPAs) let alone a professional accounting body. Second, financial information on the performance and position of organizations was not publicly available. In any case, this information did not meet international standards nor did it cater to the needs of investors or lenders. Third, the users of financial information (investors and creditors) were unfamiliar with what they should demand from organizations. Fourth, financial information was not independently verified (audited) to international standards and could not be relied upon. Fifth, the entire legal framework was geared to central planning and specified exactly what information should be produced, how it should be produced, and to whom it should be provided. Finally, the regulatory entities that generally exist in market economies to oversee financial disclosure practices, such as securities exchange commissions, did not exist.

Many FSU accountants believed that transforming accounting to a market-oriented system could be accomplished simply by modernizing the chart of accounts according to internationally accepted accounting principles. A new chart of accounts was introduced in Russia in 1992 that attempted to move the Russian system closer to internationally accepted standards by providing for use of accrual accounting, recognition of some of the costs of production as costs of the product and other costs as costs of the period, recognition of a provision for bad debt and future warranty payments, and accounts to recognize the issuance of ownership shares.

Uzbekistan also took this route. In 1994 Uzbekistan adopted a new chart of accounts that had been developed by a United Nations international expert group and that incorporated some western accounting principles. However, it was necessary to supplement the chart of accounts by improving the accounting process that includes not only the recording of transactions but also their proper identification, measurement, and reporting. Since Uzbekistan had the tradition of enshrining bookkeeping and accounting practices in law, the Government decided to draft new regulations and laws to transform the system. It was recognized from the beginning that the implementation of these regulations and laws would require a large and intensive training program in the short run. In the long run, the accounting profession would have to be strengthened so that it could train its members and contribute to their professional development.

In 1992, a working group, led by the Ministry of Finance (MOF), was organized to draft the new legislation. The working group was supported by the United Nations Development Program (UNDP) and EU-TACIS (European Union – Technical Assistance to the Commonwealth of Independent States) short-term experts. The working group membership was drawn from MOF, the State Tax Committee, the Association of Accountants and Auditors (AAA), UNDP, EU-TACIS and prominent chief accountants from the main State-owned enterprises (SOEs). Work was conducted from January 1994 until December 1995. During these two years, the working group produced: a draft accounting law, including formats for financial statements; a production-cost regulation and associated materials; a revision of the 1992 chart of accounts; a draft auditing law; recommendations for a standard on foreign currency translation during periods of inflation, and preliminary recommendations for the strengthening of the accounting profession. Further developments in Uzbekistan accounting and auditing arrangements took place between 1996 and 2000. Table 1 summarizes these developments.

Table 1: Development of Uzbekistan's Accounting Infrastructure

1991	Uzbekistan receives a new Chart of Accounts from Moscow.
	The Republic of Uzbekistan is established following independence from the Soviet Union.
1992	The Ministry of Finance establishes a working group to draft accounting and auditing legislation, revise the chart of accounts, and to develop a 'production-cost regulation'.
	The Association of Accountants and Auditors is established.
1993	The *Production Cost Regulation (PCR)* is promulgated which, in simple terms, guides accountants on how to prepare income statements. It also separates financing accounting from tax accounting.
	The UNDP / EU-TACIS supported Accounting Reform Project begins. One of its objectives is to provide accountancy and auditing training to over 100,000 'accountants'.
1994	The first Accountancy Training Resource Center is established at Tashkent State Economic University with assistance from the British Council.
	A new Chart of Accounts is adopted that incorporates aspects of western accounting principles.
1996	The *Law on Accounting* is approved. The law defines general accounting principles, the roles and responsibilities of entities, accounting practices and financial reporting requirements. It applies to both public and private sector organizations.
1997	Further Accountancy Training Resource Centers are established at the Samarkhand Cooperative Institute and at the Andijan Institute of Economics and Engineering.
1998	The first set of National Accounting Standards, which are based upon International Accounting Standards, is promulgated.
2000	The *Law on Auditing* is promulgated. The law tightens auditor certification procedures and clarifies the roles, responsibilities and liabilities of auditors.
	A revised Chart of Accounts is promulgated which is aligned with National Accounting Standards.
	The first set of National Auditing Standards, which are based on International Auditing Standards, is promulgated.
	The *Law on Auditing* provides for the establishment of a new professional body – the Republican Union of Auditors.
	The Association of Accountants and Auditors is admitted to full membership of the International Federation of Accountants (IFAC).

3. The 'Uzbekistan Accounting System'

Governing Laws, Regulations, and Other Requirements

The *Accounting Law 1996* governs the 'Uzbekistan accounting system' – it came into force on 1 January 1997.[19] The process by which this Law was developed is described above. The Law defines the general accounting principles, the roles and responsibilities of entities, accounting practices, and financial reporting requirements. The school of key laws, regulations, and requirements that govern accounting arrangements in Uzbekistan are described in the following table.

Title	Year	Description
Accounting Law	1996	This Law came into effect on 1 January 1997 and was developed with EU-TACIS and UNDP assistance. It governs the accounting and financial-reporting arrangements of government agencies, other legal entities and individuals conducting entrepreneurial activities. The Law assigns most responsibility for the regulation of accounting and financial reporting, and the design and approval of accounting standards, to the Ministry of Finance. The Central Bank is responsible for the accounting and reporting practices of financial institutions. The Law makes organization chiefs responsible for accounting arrangements. It also requires that internal reporting systems, robust record-keeping procedures, external reporting systems, and systems for meeting taxation requirements, be established and maintained. It requires that financial reports contain balance sheets, results reports (income statements), fixed assets reports, fixed assets movement reports, cash flow reports, capital reports, and supporting notes, calculations and descriptions. Article 19 requires that financial reports be submitted to tax agencies, organization owners, government statistics agencies, and other agencies according to regulations.

19 The Law on Accounting was submitted to the Olij Majilis (Parliament) in September 1995 and was passed on 30 August 1996.

Title	Year	Description
Production Cost Regulation (PCR)	1993	In contrast to other FSU countries, Uzbekistan realized that, for accounting reform to succeed, it would be necessary to separate financial accounting from tax accounting so as prevent tax rules from distorting financial information. This separation was achieved through the PCR. The PCR, also known as the 'Regulations on the Composition of Expenses on the Production and Marketing of Goods', was effective from 1 January 1995. The PCR contains a detailed classification of items to be included in production costs for the purposes of arriving at taxable income. In simple terms, it instructs accountants how to produce the income statement. The PCR was a key element in the Uzbekistan accounting reforms. This has been belatedly recognized by other FSU countries, which, in the past couple of years, have begun to examine Uzbekistan's experiences in this area.
Chart of Accounts and Instructions	2000	The Chart of Accounts and accompanying Instructions are a key part of the accounting system. As described above, the MOF introduced a new chart of accounts in 1994, reflecting international accounting practices. This chart of accounts was subject to a number of revisions over the ensuing few years – for instance, to accommodate the introduction of the PCR. In 1999, the Cabinet of Ministers decreed that the Chart of Accounts should be further updated to align with the new National Accounting Standards (NAS) that were based on IAS.[20] The new Chart of Accounts and Instructions were developed as a coordinated effort between the Ministry of Finance and USAID consultants. They were approved, and were registered with the Ministry of Justice on 1 June 2000, as National Accounting Standard 21. Around 80 regulations must be amended before the new Chart of Accounts takes effect on 1 January 2002. In addition to the New Chart of Accounts and

20 Decree of the Cabinet of Ministers (No. 54), 5 February 1999.

Title	Year	Description
		NAS, the Ministry of Finance, together with USAID consultants, developed the new forms of financial statements, initial documentation, order-journals and books of register.
National Accounting Standards (NAS)	1998 –	The Ministry of Finance is gradually developing a series of National Accounting Standards, based upon International Accounting Standards (IAS). The development processes, and the standards themselves, are described in chapter IV.
Law on Joint Stock Companies and Protection of Shareholder Interests	1996	This Law prescribes specific accounting and reporting arrangements for joint stock companies, including that annual report data must be independently audited before publication, and annual reports must be made available to shareholders and must be published in the media.
Law on Business Companies and Partnerships	1992	This Law prescribes specific accounting and reporting arrangements for business companies and partnerships, which include State-owned enterprises. In particular, the Law specifies that: owners have the right to receive information about company activities including bookkeeping data, financial information and other records; and that the financial reports of limited liability companies must be approved at Annual General Meetings.

Accounting Bases and Principles

Article 6 of the *Accounting Law 1996*, which applies to both private and public sector organizations, states that the basic Uzbekistan accounting principles are: the maintenance of accounting records on the basis of the double-entry system; continuity of accounting (going concern); monetary measurement of transactions, assets and liabilities; truthfulness of accounting data; accrual measurement; prudence (conservatism); substance over form; comparability; neutrality; matching principle; and historical cost.

Asset Management and Internal-Control Systems

The asset management arrangements for public and private sector organizations are stipulated in the *Law on Accounting 1996* and NAS 19 –

Arrangements for Managing Inventories. According to Article 11 of the *Accounting Law 1996*, stocktakes must be conducted: (i) when property is transferred, by way of lease, purchase or sale; (ii) prior to the preparation of annual financial statements; (iii) when physical assets and valuable inventories are revalued; (iv) prior to changes in responsible persons; (v) upon the disclosure of fraud, theft or damage of valuables; (vi) in the case of events outside the control of the entity; and (vii) upon the winding up or termination of the entity.[21] Article 7 of the *Accounting Law 1996* requires organization chiefs to develop and maintain internal reporting systems, systems for controlling the economic activities of the organization, robust record-keeping procedures, and a system for ensuring that payments are made on time.

Accounting Information Systems

Domestically produced software, and adapted Russian software, is generally used for accounting, banking, payroll, and human resources. However, Oracle products are gaining a foothold in the market and the company has implemented Enterprise Resource Planning systems in many of the large government agencies, state-owned enterprises, and financial institutions.[22] All banks, except one, are computerized.

In 1999, USAID, accounting firm KPMG and the Accountants and Auditors' Association, organized a computer exhibition that focused on accounting information systems. The exhibition was visited by 2,500 people, the majority of whom were either enterprise heads or chief accountants (the *Accounting Law 1996* requires that every organization must appoint a chief accountant). The exhibition emphasized software that was compatible with National Accounting Standards (NAS) and the new Chart of Accounts. Eighteen Uzbekistan firms participated in the exhibition. Visitors were given an opportunity to compare financial reporting software and to assess the ability of this software to meet the requirements of NAS and the new Chart of Accounts.

21 Inventory stocktakes must be conducted at least once every two years, library collection stocktakes must be conducted once every five years, and monetary assets and valuables must be verified monthly (NAS 5).

22 U.S. Department of State, 2000. IMI: *Uzbekistan: Computer Hardware and Software Market Brief.*

4. Financial Reporting Requirements

The basic financial reporting requirements, in accordance with the *Accounting Law 1996*, *Enterprise Law 1991*, and the *Taxation Code 1998*, are as follows: (i) accounting data must be prepared with guidance from NAS, and financial reports must be based on that accounting data; (ii) the annual financial reports of enterprises and organizations must be made available to banks, stock exchange, investors, lenders, creditors, and others; and (iii) open companies,[23] insurance organizations, banks, stock and commodity exchanges, investment funds, and other financial agencies, must publish their audited financial reports.

Table 2 presents the external reporting requirements for private sector organizations. Enterprises with foreign investment capital need only submit annual financial reports (Forms 1–5). All financial reports must be submitted to: tax authorities, shareholders, and state statistics agencies. With the exception of externally enforced reporting requirements for government executing agencies (chapter VI refers), benchmarks, covenants, and ratios are not mandated for reporting purposes.

The USAID-funded accounting reform project has assisted 435 Uzbekistan enterprises to convert their accounting systems from the existing chart of accounts to the new IAS-based chart of accounts. Although many types of enterprises participated in this effort, medium-sized enterprises engaging in manufacturing activities were primarily selected for conversion.

5. Bookkeepers and Accountants

The MOF estimates that Uzbekistan has around 400,000 to 500,000 public and private sector ‘accountants’ of whom 148,000 are chief accountants (the *Accounting Law 1996* requires every organization to have a chief accountant – they do not have to be certified accountants).[24] These ‘accountants’ are equally divided between the public and the private sectors. This surprisingly high estimate is due to the:

- predominance of manual transaction-processing systems
- inclusion of bookkeepers, tax inspectors, and record keepers in the estimate, and

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[23] Open companies are allowed to issue shares to the general public. Closed companies are not allowed to issue shares to the general public.

[24] The Deputy Minister of Finance confirmed these estimates.

- significant compliance requirements imposed on organizations by regulations and statistical reporting requirements (Uzbekistan has an abundance of regulations and decrees, many of which are accompanied by the requirement to reports to a range of government agencies).

Table 2: External Financial Reports of Private Sector Organizations[25]

Description / Details	Legal Requirement	Regularity	Required Timing	Estimated Timeliness
Form 1: Balance Sheet	*Enterprises Law 1991* *Accounting Law 1996*	Quarterly	As specified by the Ministry of Finance	Fines and penalties reinforce the submission dates. For instance, tax payments are increased by up to 10% for late filing. As such, filings are quite timely.
Form 2: Statement of Financial Performance		Quarterly		
Form 2a. Statement of Creditors and Liabilities		Quarterly		
Form 2b. Statement of Financial and Economic Condition (No. of employees, Capacity utilization, raw material sources, creditors, etc).		Annually	Up to 15 February	
Form 3. Movements in Physical Assets		Annually	Up to 15 February	
Form 4. Statement of Cash flows		Semi-Annually		
Form 5. Statement of Movements in Equity		Annually	Up to 15 February	

25 All legal entities with the exception of budget agencies, insurance organizations, and banks.

Part Two. Auditing

6. Introduction

Up until 1991, auditing in the Soviet Union, which included Uzbekistan, reflected the highly prescriptive nature of the underlying accounting system. It was primarily a verification exercise, with the final accounts being compared to bookkeeping records by accountants from another enterprise within the same group. It is not surprising that a fully functioning and competent audit profession has not been created within the short timeframe of ten years.

With the exception of a few large international firms, auditing in accordance with International Standards on Auditing (ISAs) is a relatively new concept in Uzbekistan. As such, qualified audit certificates have not been issued in Uzbekistan as National Auditing Standards (which are based upon ISAs) have only been recently introduced (10 June 2000) with the *Auditing Law 2000*.

7. Governing Laws and Regulations

Private sector auditing requirements are prescribed by the laws on: Enterprises, Business Companies and Partnerships, Accounting, Audit, and Joint-Stock Companies. The *Auditing Law 2000* was passed by Parliament on 26 May 2000 and took effect from 1 September 2000. It governs auditing activities (attest audits, performance audits, and associated services); procedures for bank auditing are the responsibility of the Central Bank. The *Auditing Law 2000* was developed in response to concerns over the competency and independence of auditors. The Law clearly sets out the structure, rights, responsibilities, and duties of the auditing profession. It also prohibits government organizations and committees from conducting audits.

The *Auditing Law 2000* defines two types of audit reporting as follows. First, the **audit report** provides detailed information on the audit inspection process, bookkeeping and accounting issues, financial reporting violations, and any other information received during the audit. The report must contain recommendations on addressing deviations and violations, and proposals for improving the operational, financial and economic performance of the entity. Where audits are conducted upon instructions from shareholders, controlling, or law-enforcement agencies, the audit report must be provided to these parties [Article 18]. Second, the **audit conclusion** provides an opinion on the authenticity of the financial statements and whether they comply with legal requirements [Article 19].

8. Audit Requirements

Article 10 of the *Auditing Law 2000* states that the following organizations must be audited on an annual basis; joint-stock companies, banks and other credit-issuing organizations, insurance organizations, investment funds, charities and other organizations that receive charitable donations, funds that are financed from compulsory contributions (e.g., road funds), and entities that are partially owned by the Government.

9. Auditor Licencing

Auditing licences are currently issued by the MOF to auditing companies. These companies must employ at least two certified auditors. Auditors are certified by the decision of the Special Certifying Committee, which comprises representatives from nongovernmental professional organizations, the MOF, and auditing firms.

The new *Auditing Law 2000* will tighten up auditor licencing. In particular, it states that audits can only be conducted by licenced audit firms. All audit firms must be registered with the Ministry of Justice. The Law makes audit firms legally liable for the quality of their work and for the accuracy of their opinions, requires that an audit firm must employ at least two certified auditors, and requires that audit firms must meet and maintain minimum capital adequacy requirements.

Article 21 of the *Auditing Law 2000* states that audit licences will be issued by a specially authorized state agency which will also: (i) design and approve norms regulating audit activities including national audit standards; (ii) control compliance of auditing organizations with their licensing agreement; (iii) set qualification requirements for candidates to be qualified as auditors; (iv) approve educational programs and the framework of examinations; (v) conduct exams; (vi) revoke and terminate audit licences and publish information in the media about suspension or termination of audit licences; (vii) issue, suspend, and revoke qualification certificates; and (viii) maintain a register of qualified individuals and licenced organizations.

The process for issuing auditing licences was approved by the Cabinet of Ministers on 22 September 2000.[26] The *Auditing Law 2000* also provided for the establishment of the *Republican Union of Auditors*, which is a nongovernmental, noncommercial organization that represents auditors on a voluntary basis. The Union's objectives are to assist in the development of, and to provide support to, professional auditors, and to defend their professional interest. Its role will be to: participate in the design and approval of the curriculum and structure of the qualifying examinations, conduct the qualifying exams, and design and prepare proposals on improving audit legislation.

10. Bank Auditing

The Central Bank is responsible for supervising the operations of banking organizations. In relation to accounting and auditing, the Central Bank:

- establishes rules for the conduct of banking operations, bookkeeping, bank statistical reporting, and annual reporting, and
- has the right to: receive and inspect reports and other bank documents, and to demand information on operations and transactions; establish internal audit requirements for banks; instruct a bank to improve its operations and procedures; specify the qualification requirements for the head and chief accountants of banks and their branches.

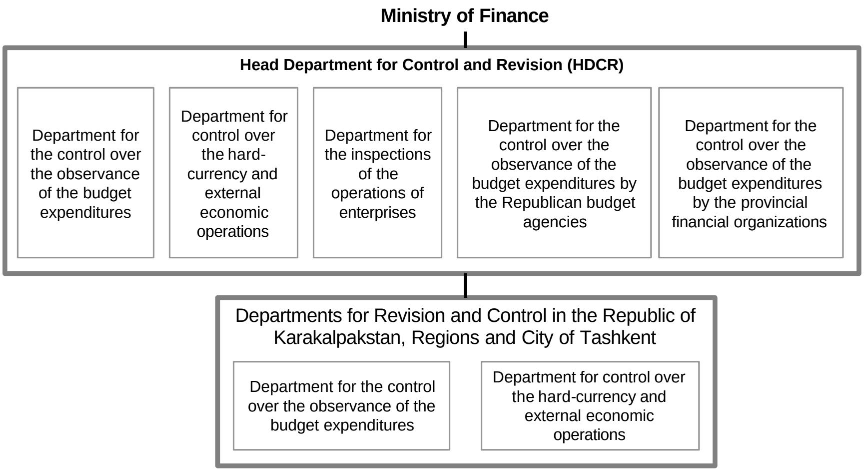
Inspections of banking organizations, owned partly or wholly by the Government, are carried out by authorized representatives of the Central Bank and by auditors appointed by the Central Bank. Private banks on the other hand have the right to select and appoint their own auditors. The Central Bank is authorized to require auditors to follow the Central Bank's legislation, including its procedures and methodology, and also to directly receive information related to bank audits.

[26] Resolution of the Cabinet of Ministers (No. 365). 22 September 2000. *On the Improvement of Audit Activity and Promotion of the Role of Audit Inspection.*

11. Public Sector Auditing

Uzbekistan does not have a Supreme Audit Institution (SAI). The Head Department of Control and Revision (HDCR), a division of the MOF, is the organization that is closest in concept to an SAI.

Figure 1: Organizational Arrangements of HDCR



The HDCR monitors financial activities, using a transaction-based approach (i.e., examination of financial transactions, identification of financial discrepancies, and fraud investigation). HDCR's auditors have little experience in conducting value-for-money audits and reviewing internal-control systems. Moreover, compliance audits focus on compliance with budget rules and regulations. Reviews do not involve the attestation of financial statements.

As a division of the MOF, the HDCR would not appear to be independent from the Executive. However, the Government contends that the HDCR is independent as the Minister of Finance submits its reports directly to the Parliament.

12. Accounting and Auditing Firms

Four of the 'big five' international accounting firms are represented in Uzbekistan: Arthur Andersen, Ernst & Young, KPMG, and PriceWaterhouseCoopers. As of June 2000, there were 517 registered auditing companies in Uzbekistan – 108 of these companies are subsidiaries of government agencies. The Government has recognized that these arrangements undermine auditor independence and the new *Auditing Law 2000* prohibits such linkages.

Concerningly, 394 of these auditing companies have equity capital levels ranging from SUM200 to SUM100,000 ($0.29–$147). Many of these companies do not have offices and, in the opinion of some workshop attendees, do not even conduct audits. Moreover, in undertaking audits, many of these firms expose themselves to liabilities far in excess of their financial resources, i.e., they are not financially accountable for their audit conclusions (opinions). The new *Auditing Law 2000* recognizes this and stipulates minimal capital requirements for auditing firms.